

Message Text

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E.O. 11652: GDS

TAGS: ENRG OECD

SUBJECT: ENERGY: BILATERAL OIL DEALS

1. SUMMARY. MISSION BELIEVES IT WOULD BE USEFUL TO BOLSTER PUBLIC POSITION OF U.S. IN OPPOSITION TO UNRES- TRAINED BILATERAL OIL DEALS WITH RATIONALE GIVEN BELOW. END SUMMARY.

2. PROBLEM. IMPORTANT ELEMENT IN U.S. POSITION WITH REGARD TO CURRENT PETROLEUM SITUATION IS THAT MAJOR CONSUMING COUNTRIES SHOULD CONCENTRATE TO SOME DEGREE THEIR OIL PUR- CHASING POLICIES, SO AS TO ESTABLISH AGREED GENERAL FRAME- WORK FOR APPROACHES TO PRODUCERS, AND THAT SCRAMBLING BY INDIVIDUAL COUNTRIES FOR NEW OIL CONTRACTS WOULD BE DETRI- MENTAL TO SCRAMBLERS AS WELL AS TO WORLD COMMUNITY. THIS VIEW HAS IN EFFECT BEEN IGNORED OR EVEN REJECTED BY SEVERAL MAJOR CONSUMING GOVERNMENTS, WHICH HAVE NEGOTIATED BILATERAL CONTRACTS. SOME (U.K., GERMANY, JAPAN) HAVE ACTED QUIETLY OR IN EMBARRASSED SELF-EXCUSE, WHILE FRANCE HAS

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OPENLY PROCLAIMED ITS BEHAVIOR AS POSITIVE VIRTUE OF

BREAKING DOWN MONOPOLISTIC POSITION OCCUPIED BY U.S. FIRMS IN "AMERICAN RESTRICTED HUNTING PRESERVES" OF MIDDLE EAST. RESULTS SO FAR ARE NOT ONLY THAT U.S. IS LOSING SOME POINTS ON PUBLIC RELATIONS ACCOUNT, BUT MORE IMPORTANTLY THAT THE DAMAGING RESULTS OF COMPETITIVE SCRAMBLING ARE TAKING EFFECT.

3. RECOMMENDED U.S. POSITION. UP TO NOW, U.S. STAND FAVORING CONCERTATION AND AGAINST SPECULATIVE BIDDING, AS EXPRESSED PUBLICLY, HAS BEEN CONFINED LARGELY TO ASSERTING CONCLUSION THAT UNRESTRICTED COMPETITIVE BILATERAL NEGOTIATIONS WILL HAVE INJURIOUS EFFECTS. WHILE WE ARE NO DOUBT DEVELOPING PROPOSALS FOR A MULTILATERAL CONTEXT IN WHICH BILATERAL DEALS COULD SAFELY BE NEGOTIATED, IT MIGHT BE VALUABLE AS WELL TO SPELL OUT REASONING ON WHICH CONCLUSION ABOUT GOING-IT-ALONE IS BASED. WE PRESUME THAT CASE BEHIND OUR STAND INCLUDES FOLLOWING ELEMENTS:

(A) PRICE. OIL-PRODUCING COUNTRIES NO LONGER NEGOTIATE WITH COMPANIES TO SET PRICES BUT ACT UNILATERALLY. THEY HAVE NOT ARRIVED AT A FIXED PRICE FORMULA BUT ARE TESTING ECONOMIC AND POLITICAL LIMITS OF MARKET, SO SITUATION IS HIGHLY UNSTABLE. A KEY ELEMENT AFFECTING PRODUCERS' JUDGMENT IS PRICE THEY RECEIVE FOR OIL THEY GET THROUGH PARTICIPATION OR OTHER ARRANGEMENTS. BILATERAL DEALS UNDER CURRENT CONDITIONS AND OUTSIDE AGREED CODE OF CONDUCT OR GUIDELINES MAY TEND TO CONFIRM CURRENT PRICES, WHICH OTHERWISE MIGHT NOT BE SUSTAINABLE. THEY ALSO MAY REDUCE QUANTITY OF OIL AVAILABLE FOR ACTUION SALES BY PRODUCERS, ENCOURAGING HIGH PRICES IN THIS NARROW AND VOLATILE MARKET. RESULTING HIGH AUCTION PRICES ARE CITED BY PRODUCERS AS EVIDENCE OF OIL'S TRUE VALUE AND AS JUSTIFICATION FOR RAISING COST OF OIL TO COMPANIES THROUGH WHICH BULK OF CONSUMERS' REQUIREMENT STILL SUPPLIED.

(B) SUPPLY. THERE IS NO REASON TO BELIEVE BILATERAL DEALS WILL INCREASE TOTAL WORLD SUPPLY. SEVERAL MAJOR EXPORTERS ARE ALREADY PRODUCING AT MAXIMUM RATES. SOME
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OTHERS, LIKE SAUDI ARABIA, COULD PRODUCE MUCH MORE BUT HAVE NO SHORT-TERM USE FO HIGHER INCOME LEVELS, SINCE THEY ALREADY HAVE ALL THE INCOME THEY CAN USE AT THEIR PRESENT STATE OF DEVELOPMENT. WITHOUT AN INCENTIVE TO PRODUCE MORE OIL, THEY ARE MORE LIKELY TO SHIFT OIL TO BILATERAL CUSTOMERS FROM OTHERS THAN TO INCREASE TOTAL PRODUCTION.

(C) ABSORPTIVE CAPACITY. IT IS ARGUED THAT BILATERAL BARTER ARRANGEMENTS INCREASE ABILITY OF THESE PRODUCERS TO USE INCREASE INCOME. PRODUCERS DO NEED TECHNOLOGY AND EQUIPMENT FOR DEVELOPMENT BUT BILATERALS ARE GENERALLY INEFFICIENT MEANS OF OBTAINING THEM. PRODUCERS ARE BETTER OFF BEING ABLE TO BUY WHAT THEY NEED FROM MOST ECONOMIC SOURCES. THEY CAN BEST DO THIS WITH UNTIED FUNDS. STIMULUS AND GUIDANCE FOR DEVELOPMENT PROJECTS, IF NEEDED, MIGHT BETTER BE OBTAINED FROM DISINTERESTED MULTIMATERIAL SOURCE MUCH AS WORLD BANK, RATHER THAN FROM GOVERNMENT SEEKING OIL.

(D) ALTERNATIVE ASSETS. PRODUCERS MUST THEREFORE BE ABLE TO EXCHANGE OIL FOR OTHER ASSETS WHICH WILL BE WORTH MORE IN FUTURE YEARS THAN OIL LEFT IN GROUND FOR FUTURE PRODUCTION. INFLATION AND MONETARY INSTABILITY MAY ON THE CONTRARY PERSUADE THEM TO DEFER PRODUCTION. CLOSE COOPERATION AMONG MAJOR WORLD ECONOMIC POWERS, WHICH ARE MAJOR OIL IMPORTERS, IS NECESSARY FOR STABLE MONETARY SYSTEM AND ASSURANCE OF RELIABLE ALTERNATIVE ASSETS. BILATERALISM IN ITS PRESENT FORM INHIBITS SUCH COOPERATION, AND IN FACT IS THE OPPOSITE OF COOPERATION.

(E) BALANCE OF PAYMENTS. BILATERALS THREATEN PRODUCERS' AND IMPORTERS' COMMON VITAL STAKE IN STABLE WORLD ECONOMIC SYSTEM IN ANOTHER WAY. OIL PRODUCERS' IMPORTS INCREASE FAR MORE SLOWLY THAN THEIR INCOMES. OIL IMPORTERS AS A GROUP WILL THEREFORE SUFFER SHARP AND UNPRECEDENTED DECLINE IN CURRENT ACCOUNTS BALANCES. BILATERAL BARTER DEALS ARE ATTEMPT TO OFFSET DETERIORATION OF CURRENT ACCOUNT BALANCES. SINCE TOTAL EXPORTS TO OIL PRODUCING COUNTRIES CANNOT BE INCREASED, EXPORTS

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ADDED BY BILATERALS MUST BE AT EXPENSE OF SOME OTHER COUNTRY. COMPETITIVE "BEGGAR-MY-NEIGHBOR" ATTEMPTS TO PROTECT CURRENT BALANCES CAN ONLY LEAD TO ECONOMIC DISASTER, AS IT DID IN THE 1930'S. ONLY SOLUTION IS COORDINATION OF ECONOMIC POLICIES AND RECONCILIATION OF BALANCE-OF-PAYMENTS OBJECTIVES AMONG MAJOR ECONOMIC POWERS.

(F) WEAKER COUNTRIES. SOME COUNTRIES, ESPECIALLY LDCS AND SMALLER NATIONS, ARE LESS ABLE TO NEGOTIATE BILATERALS. THEY MAY NOT HAVE PRECISE PRODUCTS OR TECHNOLOGY OIL EXPERTS WANT, OR THEY MAY BE AT DISADVANTAGE FOR POLITICAL OR OTHER REASONS. CONCERN FOR THESE COUNTRIES SHOULD LEAD US TO COOPERATIVE, RATHER THAN COMPETITIVE, APPROACH THAT WILL GIVE ALL COUNTRIES

EQUAL ACCESS TO OIL MARKET.

(G) POLITICAL HAZARDS. THERE ARE MANY DANGEROUS
POLITICAL IMPLICATIONS TO UNRESTRAINED BILATERALISM -
INCLUDING DANGER OF ACCELERATING ARMS RACE IN MIDDLE
EAST. ONE IMPORTANT FUNCTION OF INTERNATIONAL OIL
COMPANIES IN PAST HAS BEEN TO ACT AS BUFFER BETWEEN
PRODUCERS' AND IMPORTERS' GOVERNMENTS.
POSSIBILITIES FOR POLITICAL CONFLICT HAVE THEREBY BEEN
REDUCED. THAT ROLE OF COMPANIES IS NOW BEING ERODED.
WE NEED NEW MULTILATERAL ARRANGEMENT TO ABSORB POLITICAL
PRESSURES THAT MIGHT OTHERWISE FLARE UP TOO OFTEN FOR
COMFORT, IF MARKET CHARACTERIZED BY
UNRESTRAINED, COMPETITIVE, BILATERAL GOVERNMENT-TO-
GOVERNMENT DEALS.BROWN

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